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No. 93-1284

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

HOECHST CELANESE CORPORATION,
HOECHST CELANESE RETIREMENT PLAN,
Cross-Petitioners,

v.

LEONARD GILLIS, VALDO SARGENI,
for Themselves and All Others Similarly Situated,
Cross-Respondents.

On Cross-Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF OF CROSS-RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

1. Whether legislative history and Revenue Rulings 85-6 and 86-48 on the proper treatment of contingent liabilities in a pension plan transfer are a reasonable construction of 26 U.S.C. §§ 414(1), 411(d)(6)(B), 414(a) and their labor law counterparts, 29 U.S.C. §§ 1058, 1054(g)(2), 1060(b) in evaluating a clearly erroneous calculation by an actuary with no apparent experience in such matters.

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STATUTORY PROVISIONS

Cross-Petitioners have omitted reference to 29 U.S.C. § 1060(b) which is fully set forth in the text of this brief.

STATEMENT OF THE CASE

Background

The American Hoechst Corporation Retirement Plan and the Celanese Retirement Income Plan formally merged on April 1, 1988 to form the Hoechst Celanese

Retirement Plan. A notice to employees advised them of the merger and benefit changes at the time.

At the time of the merger, the American Hoechst Plan had assets with a market value of $198,942,408. It was fully funded for accumulated benefit obligations ("ABO") of $159,494,367 and nearly so for projected benefit obligations ("PBO") of $217,595,973.[1] The Celanese Plan had assets with a market value of $110,198,503. This was short of accumulated benefit obligations of $137,242,881 and well under a projected benefit obligation cost of $260,754,706.

The Retirement Plan booklet distributed at the Hoechst Celanese plant in Delaware City on the merger announced the adoption of unreduced early retirement when age and service totalled 85 (so called "Rule of 85" benefits) or at age 60 with 15 years of service ("60/15

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[1] The actuarial testimony below defined the "accumulated benefit obligation" (ABO) as the actuarial present value of benefit rights based on service to a particular calculation date. The "projected benefit obligation" is the actuarial present value of benefits expected to be earned between the present and a future retirement age from increasing service, changes in compensation and other factors.

Actuarial present value (APV) is a function of assumptions about future investment return on plan assets ("interest") as well as expected retirement age (the beginning date for payment) and mortality (death, the ending point for a life annuity). The actuarial present value of a benefit is the basic annual (or monthly) dollar amount of a payment discounted for assumed interest to a present value and then multiplied by the probability (1%, 50%, etc.) that an employee will be alive at the scheduled payment date. As to unvested or contingent future benefits, standard and routine actuarial practice also adds a "turnover" assumption about the probability that employees will continue to work for company, so as to vest, earn additional benefits or satisfy payment conditions. The basic APV of the contingent right is multiplied by this probability to obtain a final actuarial present value for the contingent claim. Cf. *Matter of Xonics Photochemical, Inc.*, 841 F.2d 198, 199-200 (7th Cir. 1988) (explanation of calculation of economic value of contingent claims).

benefits") for all Hoechst Celanese employees. This matched benefits for former American Hoechst employees to Celanese benefits. It also brought the greatly overfunded American Hoechst plan into rough funding equivalence with the Celanese Plan before their merger to prevent loss of benefits or benefit security for former American Hoechst employees.[2] The formal pension plan document confirmed this change in a table. Its application to the Delaware City employees, including Cross-Respondents, is uncontested.

Hoechst Celanese subsequently sold the Delaware City operations to a venture capital firm, American Mirrex Corporation ("Mirrex"). The sales agreement between Hoechst Celanese and Mirrex provided for a transfer of assets and prior liabilities for Delaware City employees covered by the Hoechst Celanese Retirement Plan to a new Plan set up by American Mirrex as of August 31, 1989. The companies used a single actuarial firm to handle the transfer, Towers, Perrin, Forster & Crosby—with a senior actuary, Mr. Feuer, representing Hoechst Celanese and a junior actuary, Mr. McKeown, representing Mirrex.

Towers Perrin calculated the amount of assets and liabilities to be transferred under the Sales Agreement using the actuarial assumptions of the Hoechst Plan as an "ongoing" business (so-called "minimum funding" assumptions). Mr. Feuer certified that this transfer complied with 29 U.S.C. § 1058 (through its tax parallel, 26 U.S.C. § 414(1)) under the "safe harbor" of 26 C.F.R. 1.414

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[2] The total ABO of both plans was roughly $351.9 Million after merger on December 31, 1988 as against the sum for two separate plans before the merger on January 1, 1988 of roughly $296 Million. The combined PBO was $562 at December 31, 1988 as against the sum for separate plans of $477 Million on January 1, 1988. The difference reflects the benefit improvements. The combined plan assets of $387.2 Million at December 31, 1988 remained in excess of the ABO of the merged plans. Assets increased to $523.1 Million by December 31, 1989 against an ABO of $433.8 Million.

(1)-1(n)(2) which covers situations in which all accumulated benefits were funded (under plan termination or liquidation assumptions) by the assets transferred.[3] Mr. McKeown, the actuary for Mirrex, had no experience with liquidating or terminating pension plans and the differences in assumptions and methodology from an ongoing plan which result from the change.

Mr. Feuer issued the certification without doing the actual calculation for a terminating or "liquidating" plan specified by 29 U.S.C. §§ 1058, 1344 and 29 C.F.R. Part 2619 for a transfer and thus shortchanged the Mirrex Plan. The junior actuary, Mr. McKeown, may not even have been aware of Rule of 85 benefits before this lawsuit as he issued later actuarial valuations for Mirrex without indicating such an option. But see, n. 4, *infra*. This caused him to calculate lower benefits than the plan document provided. The failure of Towers Perrin to use the standardized PBGC methodology compounded the problem through systematic errors in assumptions about expected retirement age, investment return, mortality and other factors. See n.1, *supra*.

Plaintiffs introduced the affidavit of Richard Schultz, a former head of the Peat, Marwick actuarial branch in Philadelphia with experience on over fifty (50) terminations, to show the effect of the errors in the Towers Perrin approach. Mr. Schultz' calculations, accounting for Rule 85 benefits and standardized retirement age, interest and mortality factors under PBGC regulations at 29 C.F.R. Part 2619, showed that a transfer of $3,603,932 was necessary for full funding for the Delaware City group as certified—75% greater than the $2,098,500 actually transferred.[4]

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[3] The IRS regulations under 26 U.S.C. § 414 also apply to 29 U.S.C. § 1058 under 29 U.S.C. § 1202(c).

[4] The correct number is almost exactly equal to an original "estimate" by Mr. McKeown of $3.5 Million after accounting for interest due to a delay in transfer. The legal work on the transac-

Proceedings

The District Court admitted that the adequacy of funding was clearly in dispute and would prevent summary judgment if funding was relevant, Cross-Petition, p. A-40. The District Court avoided docket delay on this account by finding that Messrs. Gillis and Sargeni did not have standing to complain under *Berger v. Edgewater Steel Co.*, 911 F.2d 911 (3d Cir. 1990) as neither was eligible to retire with actual payment of unreduced benefits at the time of the sale of Mirrex in 1989, Cross-Petition, pp. A-40, A-41.

Cross-Petitioners Gillis and Sargeni appealed to the United States Court of Appeals for the Third Circuit. Among other things, they noted that the plain language of 29 U.S.C. § 1132(a) gives any individual participant standing to complain of a violation of 29 U.S.C. § 1058.

The Third Circuit held that the relevant issue under 29 U.S.C. § 1058 was the funding of the Mirrex plan as a whole rather than the individual eligibility of any participant, Cross-Petition, pp. A-9, A-20. Under time-honored principles of judicial deference, the Court honored the explicit addition of 29 U.S.C. § 1054(g) to protect early retirement subsidies and an IRS ruling, Revenue Ruling 85-6, 1985-1 C.B. 133, specifying the manner in which contingent benefit liabilities were to be taken into account in a termination and rulings on transfers, Cross-Petition, pp. A-11 to A-20. Noting the District Court's observation that funding in the transfer was contested, the Court of Appeals reversed the summary judgment and remanded, Cross-Petition, p. A-20.

The Third Circuit panel distinguished *Berger* as a case in which individuals sought payment of individual benefits after a clear separation from service, Cross-

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tion was handled in-house by Ronald Silversten who now supervises the litigation response for the corporation. The corporate files of Hoechst Celanese on the pension transfer were destroyed after the lawsuit began.

Petition, p. A-19. No member of the *Berger* panel voted for rehearing to object to this distinction, Cross-Petition, p. A-44. The Eighth Circuit has likewise limited *Berger* to its factual context of an individual claim for benefits, *Adams v. LTV Steel Min. Co.*, 936 F.2d 368, 370 (8th Cir. 1991).

REASONS FOR DENYING THE WRIT

The Hoechst Celanese Retirement Plan seeks to have the Court repeal legislation—specifically 26 U.S.C. § 411(d)(6)(B) and 29 U.S.C. § 1054(g)(2). This is not a function of the Court or writ of *certiorari*. The botched calculation by the actuary for the Hoechst Celanese Retirement Plan does not otherwise present an issue worthy of this Court.

I. THE ACCRUED BENEFIT QUESTION PRESENTED BY THE CROSS-PETITION ALREADY HAS BEEN ANSWERED BY THE STATUTE AND CONGRESS

The direct question presented by cross-petition—whether early retirement subsidies are "accrued" benefits —has been answered by Congress. The secondary issue of the correct actuarial accounting for such benefits in a transfer between plans has been answered correctly and completely by the Internal Revenue Service. The Court should not allocate its precious resources to examine this guidance, which is accepted and uniformly followed by competent practitioners, because of a glaring error in this particular sale.

A 1984 amendment to the Internal Revenue Code, codified as 26 U.S.C. § 411(d)(6)(B), and the Employee Retirement Income Security Act, codified as 29 U.S.C. § 1054(g)(2), provides as follows:

> Decrease of accrued benefits through amendment of plan
>
> (1) The accrued benefit of a participant under a plan may not be decreased by an amendment of the

> plan, other than an amendment described in section 1082(c)(8) or 1441 of this titie.
>
> (2) For purposes of paragraph (1), a plan amendment which has the effect of—
>
> (A) eliminating or reducing an early retirement benefit or a retirement-type subsidy (as defined in regulations), or
>
> (B) eliminating an optional form of benefit, with respect to benefits attributable to service before the amendment shall be treated as reducing accrued benefits. In the case of a retirement-type subsidy, the preceding sentence shall apply only with respect to a participant who satisfied (*either before or after the amendment*) the preamendment conditions for the subsidy.

(emphasis supplied). The statute disposes of Hoechst's "accrued benefit" claims.

Congress itself directly explained the application of the statute to the "Rule of 85" option which Hoechst contests in this case.

> The bill provides that an amendment of a qualified plan is to be treated as reducing accrued benefits if, with respect to benefits accrued before the amendment is adopted, the amendment has the effect of either (1) eliminating or reducing an early retirement benefit or a retirement-type subsidy, or (2) except as provided by Treasury regulations, eliminating an optional form of benefit. The bill does not, however, prevent changes with respect to future benefit accruals.
>
> * * * *
>
> For example, consider a plan that provides an annual benefit of 1 percent of average pay per year of service at normal retirement age under the plan (age 65). The plan provides an early retirement benefit to a participant who has attained age 55. This early retirement benefit is actuarially reduced to 50 percent of the benefit payable to the participant at age 65. In

the case of a participant who attains age 55 and who has completed 30 years of service, the amount of the annual benefit payable beginning at age 55 is not actuarially reduced under the plan.

Under the bill, if the plan is amended on January 1, 1985 (effective on that date), to require a full actuarial reduction of early retirement benefits in all cases, then the full actuarial reduction could be made for any participant who severs employment before attaining age 55 and completing 30 years of service.

Under this plan, if a participant did *not* meet the plan's requirements for unreduced early retirement benefits on January 1, 1985, but the participant later satisfies those requirements, then the participant's accrued benefit under the plan would be the greater of (1) the accrued benefit as of the date of the plan amendment, without taking the actuarial reduction into account, or (2) the accrued benefit provided by the plan when the benefit becomes payable, after the full actuarial reduction.

The following examples illustrate the application of this provision.

Employee A was covered by the plan described above and, on January 1, 1985, was one day short of attaining age 55 and had completed 30 years of service. If A's average pay immediately before the amendment was $10,000, then A's accrued benefit at that time was an annual benefit of $3,000 ($10,000 x 1 percent x 30 years). A 50-percent actuarial reduction would reduce A's benefit payable beginning on January 1, 1985, to $1,500. Under the bill, the plan amendment could not reduce A's accrued benefit below $3,000 if A later attains age 55.

If as of January 1, 1985, employee B was age 50, had completed 25 years of service, and had average pay of $10,000, then the plan amendment could not reduce B's benefit below $2,500 (10,000 x 1 percent x 25 years). If B's average pay increased at 6 percent annually until age 55, then B's accrued

> benefit at age 55 under the plan as amended would be $4,016 ($13,382 x 1 percent x 30 years). But for the bill and prior law, the actuarial reduction would reduce B's annual benefit to $2,008. Under the bill, the amendment could not reduce B's benefit payable at age 55 below $2,500.

S. Rept. 98-575, reprinted [1984] U.S. Code Cong. & Adm. News 2547, 2574-2575. This explains the "grandfathering" concept of 29 U.S.C. § 1054(g)(2) and proper calculation of benefits.[5]

Hoechst's purported conflict in the circuits vanishes with an examination of Congressional direction.

The claim that *Harms v. Cavenham Forest Industries, Inc.*, 984 F.2d 686 (5th Cir. 1993) is inconsistent with

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[5] The conceptual interrelation between "vesting," accrual and payment of benefits underlying the "grandfathering" rule of 29 U.S.C. § 1054(g) is readily illustrated by life insurance—the most widespread example of a "vested benefit" whose payment may be contingent on future events. One may purchase a single premium ("paid-up") life insurance policy of $100,000 and acquire a "vested" contractual right to a fixed "benefit" as a result. Payment of the benefit is nonetheless contingent on future satisfaction of a condition—death. The "benefit" may grow through future purchases of additional insurance. The insurance company may not retroactively introduce new conditions for payment or exclusions for existing "paid-up" insurance but may do so as to future "accrual" through purchases of additional insurance.

The pension annuity payable during life was derived from life insurance as the simple converse of a life insurance death benefit —to reward and protect older workers who live rather than die. Under the Congressional principle that pensions are the "deferred component of compensation," *H.R. Rept. 93-533*, reprinted in [1974] U.S. Code Cong. & Admin. News at 4639, 4640, a worker purchases a portion of his benefit (including any payment options) with each year of work. See especially, 29 U.S.C. 1082(d)(5) (funding of contingent event liability even if unpredictable). As in any contract ("unilateral" or otherwise), the employer normally may modify the conditions for *future* compensation at any time but may not revoke prior commitments. 29 U.S.C. § 1054(g)(2) codifies this concept.

the Third Circuit decision in this case is utterly baffling. The Court applied 29 U.S.C. § 1054(g)(2) directly with the observation:

> . . . the beneficiaries have met all preamendment conditions for Supplement C benefits; the fact that they have satisfied them only *after* the amendment is, as we read Section 204(g), irrelevant. These were in short, vested pension benefits that had accrued and could not be reduced or eliminated by subsequent plan amendment.

Harms, 984 F.2d at 692. As noted below, it is equally irrelevant here that the employees may satisfy the preamendment conditions in this case after an amendment to change the plan and plan sponsor.

Cattin v. General Motors Corp., 955 F.2d 416 (6th Cir. 1992) dealt with temporary Social Security supplements.[6] The legislative history once again has the simple answer.

> Retirement-type subsidy
>
> The bill provides that the term "retirement-type subsidy that continues after retirement is generally to be committee intends that under these regulations, a subsidy that continues after retirement is generally to be considered a retirement-type subsidy. The committee expects, however, that a qualified disability benefit, a medical benefit, a social security supplement, a death benefit (including life insurance), or a plant shutdown benefit (that does not continue after retirement age) will not be considered a retirement-type subsidy.

S. Rept. 98-575, reprinted [1984] U.S. Code Cong. & Admin. News at 2576. The Court simply followed IRS regulations, *Cattin,* 955 F.2d at 424 & n.5, which implement this legislative history.

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[6] A Social Security supplement is a temporary supplement to the monthly benefit payment until the employee is eligible for Social Security benefits. It provides level monthly benefits in combination with Social Security.

Meredith v. Allsteel, Inc., 11 F.3d 1354, 1356 (7th Cir. 1993) involved special "window-period" benefits which are available only to those who retire in a specific time frame. The legislative history of the 1984 amendment has the following explicit exclusion on "window period" benefits:

> . . . if a benefit subsidy is provided, for example, only for employees who retire during a "window period," the provision would not require that benefits of an employee who does not retire during the window period include the window benefit.

S. Rept. 98-575, reprinted [1984] U.S. Code Cong. & Admin. News at 1574. The dictum on 29 U.S.C. § 1054 based on pre-1984 case law is obsolete but the result is not inconsistent with the statute or the Third Circuit decision in this case.

The Court has repeatedly emphasized the importance of statutory language in recent years. Review of a case with the correct statutory result will not help courts which ignore both multiple directions to read the law first as well as dispositive statutory language, Congressional committee reports and IRS regulations and rulings. The sparse resources of the Court are better directed to correcting a case with the wrong result.

II. THE PRACTICAL IMPORTANCE OF ERRONEOUS DICTA IS LIMITED AS THE IRS HAS PROVIDED CORRECT NATIONWIDE GUIDANCE WHICH IS ACCEPTED AND FOLLOWED BY COMPETENT PRACTITIONERS IN PENSION PLAN TRANSACTIONS

Congress also commented on the plan termination aspects of the 1984 amendments.

> Terminated plans
>
> [T] bill does not provide an exception to the prohibition against reduction of benefits or elimination of benefit options in the case of a terminated plan. Ac-

> cordingly, a plan is not to be considered to have satisfied all of its liabilities to participants and beneficiaries until it has provided for the payment of contingent liabilities with respect to a participant who, after the date of the termination of a plan, meets the requirements for a subsidized benefit.

S. Rept. 98-575, reprinted [1984] U.S. Code Cong. & Adm. News at 2577. The IRS issued Revenue Ruling 85-6, 1985-1 C.B. 133 (reprinted in appendix) in accordance with this direction.

The statutory language to apply the protection of contingent future payments to termination of defined benefit plans is straightforward.[7] The category of "nonforfeitable" benefits in 29 U.S.C. § 1344(a)(5) covers all benefits as to which the conditions for current payment have been satisfied at a particular date under the definition of nonforfeitable benefits in 29 U.S.C. § 1301(a)(8). The last category in 29 U.S.C. § 1344(a)(6) covers "all other benefits under the plan." It encompasses "accumulated" benefits (see n. 1, *supra*) which are protected against reduction under the separate entitlement provisions of 29 U.S.C. § 1054(g)(2) even though the conditions for payment will only be satisfied in the future, *Aldridge v. Lily-Tulip, Inc., Salary Retirement Plan Benefits Committee*, 953 F.2d 587, 590 & n.2 (11th Cir. 1992) (PBGC Opinion so holds). The Third Circuit simply and correctly deferred to the legal and actuarial expertise of the agencies in this regard.

The application of 26 U.S.C. § 411(d)(6) and 29 U.S.C. § 1054(g) to plan transfers is similarly directed by statutory language and IRS guidance. The IRS has reached the reasonable conclusion that an agreement to

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[7] The 1983 termination at issue in *Mead Corporation v. Tilley*, 490 U.S. 714, 719, 109 S.Ct. 2156 (1989) predated the 1984 statutory amendment. As *Tilley* illustrates and 29 U.S.C. § 1341(a) allows, a fully funded plan may be terminated even though employees continue to work.

exclude employees from an existing plan and transfer liabilities from one pension plan to another is an "amendment" to the transferor plan which triggers 26 U.S.C. § 411(d)(6)(B) and 29 U.S.C. 1054(g)(2). See 26 C.F.R. § 1.411(d)-4, Q&A 3 (no protected benefits may be lost in a plan transfer).

The explicit Congressional direction about inclusion of contingent benefits in a plan termination then applies to the "termination basis" calculation required by 29 U.S.C. § 1058 and 26 U.S.C. § 414(1) in the transfer. The IRS so concluded in Revenue Ruling 86-48, 1986-1 C.B. 216 (reprinted in appendix) with regard to a plan "spinoff" as in this case. It noted that any other rule would allow benefits to fall through the cracks and leave an unbalanced and unreconciled account in the transfer.

Hoechst missed the boat and mispresents the law in citing 29 U.S.C. § 1054(f) without reference to 29 U.S.C. § 1060(b) to avoid this analysis. 29 U.S.C. § 1054(f) provides that:

> Employer treated as maintaining a plan
>
> For the purposes of this part, an employer shall be treated as maintaining a plan if any employee of such employer accrues benefits under such plan by reason of service with such employer.

The application of this provision is modified in a plan transfer by 29 U.S.C. § 1060(b) which provides:

> (b) Maintenance of plan of predecessor employer
>
> For purposes of this part [including 29 U.S.C. § 1054] and part 3—
>
> (1) in any case in which the employer maintains a plan of a predecessor employer, service for such predecessor shall be treated as service for the employer, and
>
> (2) in any case in which the employer maintains a plan which is not the plan maintained by a predecessor

> employer, service for such predecessor shall, to the extent provided in regulations prescribed by the Secretary of the Treasury, be treated as service for the employer.

See also, 26 U.S.C. § 414(a) (Tax Code parallel).

Section 1060(b) bridges the transfer and substitutes the successor as the "plan sponsor" with respect to both past and future service. The IRS regulations discussed in Rev. Rul. 86-48 implement this rule in a plan "spinoff" to require credit toward contingent benefits for work with the successor. This is necessary to assure that benefits are the same before and after the spinoff as required by 29 U.S.C. § 1058 and 26 U.S.C. § 414(1).

The substitution rule focuses the "termination basis" calculation for contingent benefits in a transfer on future service with the new plan sponsor. In logical sequence, the transferee must adopt the prior plan (including its provisions for unreduced payment of benefits) in order to transfer liabilities under 29 U.S.C. § 1058. This act triggers 29 U.S.C. § 1060(b) to require the transferee to treat service *before* as well as after the transfer as work for the transferee "plan sponsor." Any change from this initial position then is subject to the explicit grandfathering rules of 26 U.S.C. § 411(d)(6) and 29 U.S.C. § 1054(g) so as to prevent contingent rights from falling through the cracks in the transfer and to require their inclusion in the transfer calculations. The bridging of service between the transferor and transferee plans essentially defines "separation from service" for purposes of 26 U.S.C. § 411(d)(6)(B) and 29 U.S.C. § 1054(g)(2) as separation from service covered by a particular pension plan—not termination from employment with any specific company.

Judge Seitz used precedent on similar language under 26 U.S.C. § 402 rather than a technical analysis of complicated statutory language. Be that as it may, Judge

Alito emphasized that his comments (and thus the holding of the panel) were limited to the situation of a transfer of liabilities covered by 29 U.S.C. § 1058, Cross-Petition, pp. A-24 to A-27.

The Eighth Circuit decision in *Hunger v. AB*, 12 F.3d 118, 62 U.S.L.W. 2436 (8th Cir. 1993) is burdened by unfortunate dictum but is not inconsistent in result. The Eighth Circuit dealt with a sale with *no* transfer of a pension plan under 29 U.S.C. § 1058. The panel noted the critical factual distinction, *id.*, 12 F.3d at 121-122 only after it veered off in a different direction under pre-1984 case law. The result in *Hunger* (two pension plans) is nonetheless correct in the absence of a plan transfer.[8]

The common law process and the IRS exist to correct the overstated dictum without burdening this Court. These processes have limited similar overbreadth in *Berger* in the courts.

The conflicting dicta of the courts have little practical impact on pension plan transactions as they are too inconsistent to provide a reliable or predictable result. Pension plan mergers and transfers are primarily quantitative matters between organizations which are guided by actuaries and accountants. These professionals know the IRS rules and have a professional skepticism about the actuarial and quantitative abilities of the legal profession. Actuaries and accountants suffer only embarrassment and loss of business by embroiling clients in administrative problems with the IRS or, worse yet, litigation. The IRS guidance provides an adequate, uniform and nationwide

[8] In the absence of a qualifying transfer, employees can receive two pensions—one from the plan of the seller and one from the buyer. Under 29 U.S.C. §§ 1053(a)(3)(B) and 1056(a), they would, however, have the right to receive reduced early retirement benefits from the seller even while working for the buyer as they no longer work for an employer who "maintains" the original plan. The economic benefit to employees and cost to employers of this option varies from case to case.

standard which is prudently followed by all but extremists at this point. The Court may conserve its sparse resources until an incorrect result disturbs the existing national guidelines of the IRS.

CONCLUSION

The cross-petition for a writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX

APPENDIX

Rev. Rul. 85-6

1985-5 I.R.B. 10
1985-1 C.B. 133

Termination; treatment of early retirement subsidy. In the proposed termination of a qualified defined benefit plan, the plan will not satisfy section 411(d)(6), as amended by the Retirement Equity Act of 1984, unless an early retirement subsidy is provided for participants who satisfy the pretermination subsidy requirements after the termination of the plan.

PURPOSE

The purpose of this revenue ruling is to consider Rev. Rul. 83-52, 1983-1 C.B. 87, in light of the enactment of section 301 of the Retirement Equity Act of 1984 (REA), Pub. L. 98-397, 1984-2 C.B. 433.

ISSUES

Will the return of the amount of plan assets determined as described below to an employer upon the termination of a qualified defined benefit plan meet the nondiversion and vesting requirements of sections 401(a)(2) and 411 of the Internal Revenue Code?

FACTS

A qualified defined benefit plan that is not a multiemployer plan described in section 414(f) of the Code provides that a participant who retires prior to the normal retirement age of 65, but after attaining age 55 and completing 30 years of service, is entitled to the immediate commencement of the participant's accrued benefit without any actuarial reduction. The plan also provides that upon termination the amount by which the value of

plan assets exceeds the present value of all participants' benefits (whether or not nonforfeitable) on a termination basis will revert to the employer maintaining the plan.

The employer who maintains the plan proposes to terminate the plan after the effective date of section 301 of REA with respect to the plan and distribute cash and annuity contracts equal to the present value of the participants' benefits. Under the proposal, unless a participant has attained age 55 and completed 30 years of service at the time of the proposed termination, such present value will not include the value of the subsidy that had been provided with respect to the early retirement benefit. Thus, participants who do not satisfy the minimum age and service requirements at the time of the proposed termination, but who subsequently satisfy these conditions, will not receive the subsidized benefit.

At the time of the proposed termination, the value of the plan assets will exceed the present value of the participant's benefits determined in this manner.

LAW AND ANALYSIS

Section 401(a)(2) of the Code and section 1.401-2 of the Income Tax Regulations provide that plan funds must not be used for purposes other than the exclusive benefit of employees or their beneficiaries prior to the termination of the plan and the satisfaction of all liabilities with respect to those individuals. Section 1.401-2(b)(2) provides that the liabilities that must be satisfied include both fixed (those nonforfeitable prior to termination) and contingent (those not nonforfeitable prior to termination) liabilities. After satisfaction of those liabilities, an employer may recover any remaining funds from the plan as surplus resulting from actuarial error.

Rev. Rul. 83-52 provides guidance on the determination of the amount that may be returned to an employer upon the termination of a defined benefit plan in accord-

ance with the nondiversion requirement of section 401 (a)(2) of the Code.

Section 411(d)(6)(B) of the Code provides that a plan amendment that has the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy or of eliminating an optional form of benefit with respect to benefits attributable to service before the amendment is treated as reducing the accrued benefit of a participant for purposes of section 411(d)(6)(A). Under section 411(d)(6)(A) such a decrease in accrued benefits results in the plan not satisfying section 411. However, section 411(d)(6)(B) provides that, in the case of a retirement-type subsidy, this prohibition applies only with respect to a participant who satisfies (either before or after the amendment) the preamendment conditions for the subsidy. The REA amendments to section 411(d)(6) described above apply generally to plan amendments made after July 30, 1984.

The explanation of REA in S. Rep. No. 98-575, 98th Cong., 2nd Sess. 31 (1984), provides:

The bill does not provide an exception to the prohibition against reduction of benefits or elimination of benefit options in the case of a terminated plan. Accordingly, a plan is not to be considered to have satisfied all of its liabilities to participants and beneficiaries until it has provided for the payment of contingent liabilities with respect to a participant who, after the date of the termination of a plan, meets the requirements for a subsidized benefit.

The right of a participant under the plan to immediate payment without actuarial reduction, if age 55 with 30 years of service, is both a retirement-type subsidy subject to section 411(d)(6)(B) of the Code and a liability for purposes of section 401(a)(2). A participant could, after the date of the proposed termination, satisfy the pretermination conditions necessary to receive this retire-

ment-type subsidy. Accordingly, the proposed termination eliminating this accrued retirement-type subsidy would result in the plan failing to satisfy the vesting requirements of section 411. Further, all liabilities will not be satisfied for purposes of section 401(a)(2) if the value of this retirement-type subsidy is not provided with respect to a participant who, after the date of the proposed termination, satisfies the pretermination conditions necessary to receive such benefit. Until the liabilities for these benefits are satisfied, the employer may not recover any remaining funds as surplus resulting from actuarial error without disqualifying the plan.

In this case, there are at least two ways in which the vesting requirements could be met, the liabilities could be satisfied, and the employer could recover any surplus. First, annuity contracts may be purchased from an insurance company that provides for the retirement-type subsidy in the event any participant, subsequent to plan terminations, satisfies the pretermination conditions of age 55 with 30 years of service necessary to receive the subsidized benefits. Second, the plan on termination may be amended to provide such subsidized benefits whether or not participants subsequently satisfy the necessary conditions. In order for the plan to remain qualified, such an increase in benefits must satisfy other Code requirements, be provided in a nondiscriminatory manner, and be distributed in a manner that is permitted with respect to an individual who has satisfied the conditions necessary for such subsidized benefits.

HOLDING

The return of the amount of plan assets determined as proposed above to the employer upon the termination of the qualified defined benefit plan will not meet the nondiversion and vesting requirements of sections 401(a)(2) and 411 of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 83-52 is modified and superseded.

Rev. Rul. 86-48

1986-14 I.R.B. 6
1986-1 C.B. 216

Spinoff; transfers; benefits on a termination basis. A defined benefit plan may fail to satisfy the spinoff requirements under section 414(1) of the Code if plan benefits included under section 411(d)(6)(B) or required under section 417(c) are not included in the determination of "benefits on a termination basis" within the meaning of section 1.414(1)-1(b)(5) and (n)(1) of the regulations.

ISSUE

Must plan benefits that are (a) included in participants' accrued benefits under section 411(d)(6)(B) of the Internal Revenue Code or (b) required under sections 401(a)(11)(A)(ii) and 417(c) be included in the determination of "benefits on a termination basis" within the meaning of section 1.414(1)-1(b)(5) and (n)(1) of the Income Tax Regulations?

FACTS

An employer maintained a nonmultiemployer defined benefit plan qualified under section 401(a) of the Code which was spunoff into two defined benefit plans as described in section 1.414(1)-1(b)(4) of the regulations. However, the benefits on a termination basis in the plan immediately prior to the spinoff was determined without regard to the benefits of participants that are (a) early retirement benefits, retirement-type subsidies and optional forms of benefits included in participants' accrued benefits under section 411(d)(6)(B) or (b) qualified preretirement survivor annuities required under sections 401(a)(11)(A)(ii) and 417(c).

LAW AND ANALYSIS

Section 414(1) of the Code provides that a plan will not qualify under section 401, in the case of any transfer of assets or liabilities of such plan to any other plan, unless each participant in the plan would (if the plan then terminated) receive a benefit immediately after the transfer that is equal to or greater than the benefit the participant would have been entitled to receive immediately before the transfer (if the plan had then terminated).

Section 1.414(1)-1(n)(1) of the regulations provides that the spinoff of a defined benefit plan will satisfy the requirements of section 414(1) of the Code if all the accrued benefits of each participant are allocated to only one of the spunoff plans and the value of the assets allocated to each spunoff plan is not less than the present value of the 'benefits on a termination basis' in the plan prior to the spinoff for all participants in that spunoff plan.

Section 1.414(1)-1(b)(5) of the regulations defines the term 'benefits on a termination basis' as the benefits that would be provided exclusively by the plan assets pursuant to section 4044 of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, and the regulations thereunder if the plan had terminated.

Sections 403(d), 4021, and 4044(a) of ERISA provide that in the case of the termination of a nonmultiemployer defined benefit plan, the assets of the plan must be allocated to participants and beneficiaries of the plan in a specified order of six different categories of benefits. The six categories of benefits include all of the participants' benefits under the plan, whether forfeitable or nonforfeitable.

Section 401(a)(2) of the Code and section 1.401-2 of the regulations provide that, upon termination of a defined benefit plan, both the fixed and contingent liabil-

ities of the plan to employees and beneficiaries (i.e., the vested and nonvested benefits of participants and beneficiaries) must be satisfied before the employer may recover any assets of the plan. Rev. Rul. 85-6, 1985-1 C.B. 133, provides guidance on the determination of the liabilities that must be satisfied upon plan termination prior to such a reversion.

Section 411(d)(6)(A) of the Code provides that a plan qualified under section 401 may not be amended (other than exceptions not relevant here) to reduce the accrued benefit of any participant. Section 411(d)(6)(B)(i) provides that a plan amendment that has the effect of eliminating or reducing an early retirement benefit, retirement-type subsidy or optional form of benefit (including any qualified joint and survivor annuity benefit required under sections 401(a)(11)(A)(i) and 417(b)) with respect to benefits attributable to service before the amendment will be treated as reducing accrued benefits. Rev. Rul. 85-6 provides that a defined benefit plan will fail to satisfy the requirements under section 411(d)(6) upon plan termination unless an early retirement subsidy that was provided prior to plan termination is provided for participants who satisfy the pretermination subsidy requirements after the termination of the plan.

Section 401(a)(11)(A)(ii) and 417(c) of the Code provide that a qualified preretirement survivor annuity must be provided to the surviving spouse of a vested participant who dies before the annuity starting date.

To satisfy the requirements of section 1.414(1)-1(a)(1) of the regulations where a nonmultiemployer defined benefit plan is spunoff, each participant's total benefits that continue after the spinoff must be allocated to one of the spunoff plans and the value of the assets allocated to each of the spunoff plans must not be less than the value of such total benefits under each plan that would be provided by plan assets in accordance with section 4044 of ERISA. A participant's total benefits in the categories

under section 4044 include (a) early retirement benefits, retirement-type subsidiaries and optional forms of benefits, described under section 411(d)(6)(B) of the Code that are part of the accrued benefit under section 411(d)(6) and (b) qualified preretirement survivor annuity benefits required under section 401(a)(11)(A)(ii), in each case, without regard to whether the participant has satisfied all of the conditions for such benefit as of the spinoff. These same benefits also must be taken into account under section 401(a)(2) and section 1.401-2 in determining the liabilities that must be satisfied upon plan termination before the employer may recover any plan assets.

In this case, the total benefits of participants were not taken into account to determine "benefits on a termination basis" with respect to the spinoff. Thus, the spinoff may fail to satisfy the requirements of section 1.414(1)-1(n)(1) of the regulations and section 414(1) of the Code.

HOLDING

The plan benefits that are (a) included in participants' accrued benefits under section 411(d)(6)(B) of the Code or (b) required under section 401(a)(11)(A)(ii) and 417(c) must be included in the determination of 'benefits on a termination basis' within the meaning of section 1.414(1)-1(b)(5) and (n)(1) of the regulations.